Supreme Court of the United States

OCTOBER TERM, 1944

No. ----

MRS. S. W. C. LUMPKIN, PETITIONER,

versus

WM. P. BOWERS, COLLECTOR OF INTERNAL REVENUE FOR THE STATE OF SOUTH CAROLINA, RESPONDENT

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I.

Opinions of Courts Below

The opinion of the United States District Court for the Eastern District of South Carolina is reported in 50 Fed. Supp., 874. The opinion of the Circuit Court of Appeals is reported in --- Fed. (2d), ----.

II

Jurisdiction

The judgment of the Circuit Court of Appeals was entered February 4, 1944. The jurisdiction of this Court is

invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, c. 229, Sec. 1, 43 Stats., 938 (28 U. S. C., 347(a)).

III

Statute Involved

Section 23(a) of the Revenue Act of 1936, as amended by Section 121 of the Revenue Act of 1942 (56 Stats., 798, 819).

"Sec. 121. Non-trade or non-business deductions

"(a) Deduction for expenses. Section 23(a) (relating to deduction for expenses) is amended to read as follows:

"(a) Expenses.

"**Trade or business expenses.**

"(A) In general. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, or property to which the taxpayer has not taken or is not taking title or in which he has no equity.

"(B) **Corporate charitable contributions.** No deduction shall be allowable under subparagraph (A) to a corporation for any contribution or gift which would be allowance as a deduction under subsection (q) were it not for the 5 per centum limitation therein contained and for the requirement therein that payment must be made within the taxable year.

"(C) **Expenditures for advertising and good will.** If a corporation has, for the purpose of computing its

excess profits credit under Chapter 2E, claimed the benefits of the election provided in Section 733, no deduction shall be allowable under subparagraph (A) to such corporation for expenditures for advertising or the promotion of good will which, under the rules and regulations prescribed under section 733(a), may be regarded as capital investments.

"(2) **Non-trade or non-business expenses.** In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

"(b) **Allocable to exempt income.** Section 24(a)(5) (relating to items not deductible) is amended by inserting after 'this chapter' the following: 'or any amount otherwise allowable under section 23(a)(2) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this chapter.'

"(c) **Depreciation deduction.** The first sentence of section 23(l) (relating to deduction for depreciation) is amended to read as follows: 'A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for absolescence)—

"'(1) of property used in the trade or business, or

"'(2) of property held for the production of income.'

"(d) **Taxable years to which amendments applicable.** The amendment made by this section shall be applicable to taxable years beginning after December 31, 1938.

"(e) **Retroactive amendment to prior revenue acts.** For the purposes of the Revenue Act of 1938 or any prior revenue Act the amendments made to the Internal Revenue Code by this section shall be effective as if they were a part of such revenue Act on the date of its enactment."

IV

Statement of the Case

A full statement of the case has been under the heading "II" in the petition and to avoid duplication is not repeated (pages ___ to ___ inclusive, *supra.*)

V

Specifications of Error

(1) The Circuit Court of Appeals erred in refusing to interpret Section 23(a) of the Revenue Act of 1936, as amended by Section 121 of the Revenue Act of 1942 (56 Stats., 798, 819), in accordance with the ordinary, popular and received import of the words used therein, and in a way so as to effectuate the purposes of Congress.

(2) The Circuit Court of Appeals erred in interpreting the term "conservation" as used in Section 23(a) of the Revenue Act of 1936, as amended by Section 121 of the Revenue Act of 1942 (56 Stats., 798, 819), in a narrow and restricted sense and in a way to defeat the plain and obvious intent of Congress.

(3) The Circuit Court of Appeals erred in not finding and holding that under the terms of Section 23(a) of the Revenue Act of 1936, as amended by Section 121 of the Revenue Act of 1942 (56 Stats., 798, 819), expenses incurred in the conservation of property held for the production of income are deductible even though such expenses were incurred in the defense of a law suit involving title to such property.

(4) The Circuit Court of Appeals erred in finding and holding that Congress, in amending Section 23(a) of the Revenue Act of 1936, used the phrase "all the ordinary and

necessary expenses'' under the caption ''non-trade or non-business expenses'' in the same sense and within the same limitations that it had previously used in connection with trade or business expenses.

(5) The Circuit Court of Appeals erred in failing and refusing to hold that the regulations promulgated by the Secretary of the Treasury, to the effect that expenses incurred in defending title to property are not deductible in computing net income, are a nullity and unenforceable with respect to expenses incurred in defending title to property held for the production of income, by reason of Section 23(a) of the Revenue Act of 1936, as amended by Section 121 of the Revenue Act of 1942 (56 Stats., 798, 819).

VI

ARGUMENT

I

The Circuit Court of Appeals Did Not Interpret Section 23(a), as Amended, in Accordance with the Ordinary, Popular and Received Import of the Words Used Therein and in a Way so as to Effectuate the Purposes of Congress.

As developed by the statement of facts, *supra*, the petition, prior to 1929, held a life estate in a one-half interest in a corporation which was the owner of valuable franchise rights in regard to the sale and distribution of coca-cola syrup. In 1930 she purchased in her own right the other one-half interest in the stock of this company for the sum of $255,885.00, and for several years thereafter managed and directed the affairs of said company, during which time she received the dividends declared and paid on such shares of stock. In 1936 a suit was brought against her to set aside

the sale of the stock she acquired in 1930, upon the ground that the trustees from whom she purchased it had no authority to make such sale, upon the repayment to her of the purchase price thereof, with interest. In this suit it was also sought to require the petitioner to account for all income and profits from the said stock which she had received from the date she purchased it until the time of the institution of the suit. The petitioner employed attorneys to defend and conserve her interest in said stock and to sustain the validity of the sale, and in doing so she incurred expenses, covering costs, attorneys' fees and printing, etc., amounting to $250.00 during the year 1936, and $26,798.22 during the year 1937. These items were deducted by her in computing her net income for these respective years but such deductions were disallowed and as a result thereof a deficiency tax and interest was assessed against her in the sum of $19,342.72, which taxes were paid under protest. It is further developed by the record that in addition to the demand for an accounting of the dividends received from said stock during the time the petitioner held the same, the State also contended that the petitioner, for herself and for the benefit of her general manager, withdrew excessive salaries and claimed that if said salaries were adjusted to a reasonable basis, one-half of the average yearly income of said company for the years 1929 to 1935 would be $21,820-.34. It was further shown that if the sale was rescinded and the petitioner was paid the legal rate of interest on her investment, she would have received the sum of $14,353.10 for each of these years, which, if deducted from dividends received, would leave the sum of $6,467.24, for which the petitioner would be required to account each year for six years. It was further shown that the dividends declared by the company for the years 1936 and 1937 were greatly in excess of the dividends paid for the previous years. It is

conceded that the dividends received from this stock by the petitioner were required to be and actually were included in income for Federal income tax purposes, and taxes were paid thereon for the respective years.

We respectfully submit that if the statute in question is interpreted in accordance with the ordinary, popular and received import of the words used therein and in a way so as to effectuate the purpose and intent of Congress, the legal expenses incurred by the taxpayer are deductible because they were incurred in the conservation of property held for the production of income. The Government contends, and the Court below so held, that prior to the amendment of Section 23(a) it was firmly established by treasury regulations and decisions construing the same that legal expenses involved in defending or protecting title to property are not "ordinary and necessary expenses" and therefore not deductible from the gross income in order to compute the taxable net income, and contends further that such regulations and ruling are not affected by the 1942 amendment. No question is raised as to the reasonableness of the fee paid or the costs incurred, nor is it questioned that such expenses bore a reasonable proximate relation to the conservation of property held for the production of income.

The language used by Congress in the amendment demonstrates a clear and positive purpose to change the treasury regulations relied upon by the Government and to neutrailize any decisions giving effect thereto so as to now permit the deduction of expenses necessitated by the urgency of defending title to property held for the production of income, and that now, if such expenses are incurred for this purpose they should be regarded as ordinary and necessary notwithstanding the use made of this term prior to the amendment.

The Court below, we respectfully submit, did not i
terpret the statute in the light of the evil of the administr
tive practices it was sought to correct and in accordan
with the ordinary, popular and accepted meaning of t
words used therein; on the other hand the Court deduc
from the statute an interpretation not justified by its stru
ture. The decision superimposes on the language used t
interpretation of prior regulations defining the meaning
the phrase "ordinary and necessary" and holds that t
Congress did not intend to remove such restrictions a
limitations theretofore applicable to deductions under Se
tion 23(a) of the Act.

The language used in the amendment is clear and u
ambiguous and the purpose sought to be accomplish
thereby is likewise obvious and free from doubt. The p
mary function of the income tax laws is to raise reven
and this amendment furthers and supplements this pu
pose. In order to increase the income affected by the A
taxpayers, by the amendment, are encouraged to prote
and conserve income producing properties, and to this e
they are allowed to deduct from their gross income expe
ses, ordinarily and necessarily incurred, in connection wi
the production of income or the conservation of proper
held for the production of income. The Congress did n
make a distinction between the nature of deductible
penses so long as they were incurred in obtaining one
the ends to be gained, namely, either for the production
income or for the conservation of property held for the p
duction of income. The Court below held that it was the
tention of Congress to allow only such deductions as h
been previously defined by the Treasury Department to
ordinary and necessary and that under this definition
penses incurred in defending title to property were not
ductible.

It is respectfully submitted that if Congress had so intended it could have said so; but on the contrary, by the very language used declared that such regulations should no longer be effective where the expenses were concerned with the production of income or the conservation of property held for the production of income. While it is generally true that the statute creating exemptions must be strictly construed and that any doubt must be resolved in favor of the taxing power, it is also true that a strict construction is not called for where a common sense construction squares the plain and obvious intent of Congress. The language used by the Congress is unfettered by exceptions or nice distinctions but employs words of generally accepted and unambiguous meaning.

This Court, in *Deputy et al. v. DuPont*, 308 U. S., 488, 60 S. Ct. Rep., 363, 84 L. Ed., 416, said:

> "And when it comes to construction of the statutory provisions under which the deduction is sought, the general rule that 'popular or received import of words furnishes the general rule for the interpretation of public laws', *Maillard v. Lawrence*, 16 How. 251, 261, 14 L. Ed. 925 is applicable."

In the earlier case of *A. Magnano Co. v. Hamilton*, 292 U. S., 40, 54 S. Ct. Rep., 599, 78 L. Ed., 1109, it was said:

> "The statute here under review is in form plainly a taxing act, with nothing in its terms to suggest that it was intended to be anything else. It must be construed, and the intent and meaning of the Legislature ascertained, from the language of the act, and the words used therein are to be given their ordinary meaning unless the context shows that they are differently used."

There is nothing in the statute to indicate that the Congress used the words other than in their ordinary and popular meaning. It is accordingly submitted that the Court below decided an important Federal question in a way probably in conflict with applicable decisions of this Court.

II

The Circuit Court of Appeals Erred in Interpreting the Term "Conservation" as Used in the Statute in a Narrow and Restricted Sense and in a Way to Defeat the Plan and Obvious Intention of Congress.

The statute plainly declares that ordinary and necessary expenses incurred in the "conservation" of property held for the production of income shall be deductible. In the opinion of the Court below the meaning and connotation of this term is so narrowed and restricted as to make it applicable only to the safeguarding or protection of tangibles and did not give to such term its commonly accepted meaning. There is nothing in the context to indicate that the term was to be construed in a manner different from its ordinary and generally understood meaning. The term "conservation" has been defined as follows: "The act of preserving, guarding, or protecting; preservation from loss, decay, injury, or violation; the keeping (of a thing) in a safe or entire state." Webster's Twentieth Century Dictionary, page 360.

This Court, in *Helvering v. Hammel*, 311 U. S., 504, 61 S. Ct. Rep., 368, 85 L. Ed., 303, 131 L. R. A., 1431, said:

> "True, courts in the interpretation of a statute have some scope for adopting a restricted rather than a literal or usual meaning of its words where acceptance of that meaning would lead to absurd results. *United States v. Katz*, 271 U. S. 354, 362, 46 S. Ct. 513, 516, 70 L. Ed. 986, or would thwart the obvious purpose of the statute, *Haggar Co. v. Helvering*, 308 U. S. 389, 60 S. Ct. 337, 84 L. Ed. 340. But courts are not free to reject that meaning where no such consequences follow and where, as here, it appears to be consonant with the purposes of the Act as declared by Congress and plainly disclosed by its structure."

We therefore submit that in giving the term "conservation" a restricted rather than its usual meaning and in a way so as to defeat the purposes of the Act, the Court decided a question of Federal law in way probably different from the applicable decisions of this Court.

III

The Court Erred in Not Holding That Under the Terms of the Statute Expenses Incurred in the Conservation of Property Held for the Production of Income Are Deductible, Even Though Such Expenses Were Incurred in the Defense of a Law Suit Involving Title to Such Property.

It is true that prior to the 1942 amendment the Treasury Department had uniformly ruled that expenses incurred in defending title to property were not ordinary and necessary expenses, as that term had been used in previous revenue laws, and therefore were not deductible. However, in the 1942 amendment the Congress did not indicate that the phrase "ordinary and necessary" was differently used from its ordinary meaning, nor did it restrict the meaning of the term "conservation". We therefore submit that if legal expenses were incurred in defending title to property held for the production of income, such expenses fall within the terms of the amendment and are deductible. The Court, in holding to the contrary, decided a question of Federal law which has not been but which should be settled by this Court.

IV

The Court Erred in Holding That Congress, in Amending Section 23(a), Used the Phrase "All the Ordinary and Necessary Expenses" in the Same Sense and with the Same Limitations that it had Previously Used in Connection with Trade and Business Expenses.

We respectfully submit that it was the purpose of the Congress not only to ameliorate the harshness resulting from the decision of *Higgins v. Commissioner,* 312 U. S., 212, 61 S. Ct., 475, 85 L. Ed., 783, but to also permit deductions of all expenses incurred in the production of income or the conservation of property held for the production of income, and that such expenses were to be regarded as ordinary and necessary even though they were expended in the defense of title to property held for the production of income. There is nothing in the statute to indicate that the definition of ordinary and necessary expenses previously adopted by the Treasury Department and the Courts with regard to the expenses in defending title to property is to be used in administering the present law. On the contrary the meaning is clear that if the expenses are ordinary and necessary in the generally accepted meaning of these words and bear a proximate relation to production of income or to the conservation of property held for that purpose, that such expenses are deductible. Any other construction would thwart the obvious purpose of the statute and therefore should not be adopted. *Helvering v. Hammel,* 311 U. S., 504, 61 S. Ct. Rep., 368, 85 L. Ed., 303, 131 A. L. R., 1431.

V

The Court Erred in Giving Effect to the Regulation of the Treasury Department with Reference to What are "Ordinary and Necessary Expenses" When it was the Clear Intent and Purpose of Congress to Declare a Different Rule.

Prior to the Amendment of 1942, and subsequent thereto, the Treasury Department has ruled "the cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense."

It is respectfully submitted that this ruling, in so far as it relates to the cost of defending title to property held for the production of income, is at variance with the statute law as it now exists and is therefore unenforceable and a mere nullity. Congress clearly said that expenses incurred in the conservation of property held for the production of income are deductible and it did not otherwise delineate such "expenses".

It was amply shown in the case at bar that the petitioner acquired nothing whatsoever by defending her title. So far as she was concerned it was merely an expense of conserving what she already had. In view of the fact that Congress certainly intended to allow expenses incurred in the conservation of property to be deductible it would seem contrary to reason and right and a too narrow construction of the statute to say that merely because the expense was connected with defense of title to stock that it could not be allowed. Such a construction would appear to put a highly technical meaning on the words "defending title", which we think was never contemplated by the Act.

The Treasury Department is without authority to amend the statute law by regulation when such statute is clear and free from doubt. This Court in *Koshland v.*

Helvering, 298 U. S., 441, 56 S. Ct. Rep., 767, 80 L. Ed., 1268, gave expression to this principle in the following language:

> "Where the act uses ambiguous terms, or is of doubtful construction, a clarifying regulation or one indicating the method of its application to specific cases not only is permissible but is to be given great weight by the courts. And the same principle governs where the statute merely expresses a general rule and invests the Secretary of the Treasury with authority to promulgate regulations appropriate to its enforcement. But where, as in this case, the provisions of the act are unambiguous, and its directions specific, there is no power to amend it by regulation." (Citing *Manhattan General Equipment Co. v. Commissioner of Internal Revenue,* 297 U. S., 129, 56 S. Ct., 397, 80 L. Ed., 528.)

We therefore submit that the Court below decided an important question of Federal law in a way probably in conflict with the decisions of this Court.

Respectfully submitted,

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April 13, 1944.